

## **La'o Hamutuk**

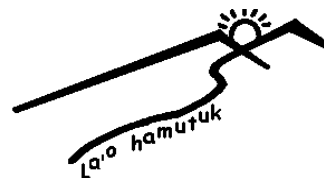
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**Submission to**  
**Timor-Leste National Parliament**  
**from**  
**La'o Hamutuk**  
**on the**  
**Proposed General State Budget for 2017**  
**7 November 2016**

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## **Introduction**

La'ó Hamutuk appreciates this opportunity to offer our suggestions on the proposed 2017 General State Budget; as always, we hope that the information in this submission will help your Excellencies make wise decisions about how to improve the proposed budget to strengthen our economy and social services to better serve the needs of the people of Timor-Leste.

Although Timor-Leste has already spent \$8 billion of what we received by converting our non-renewable oil and gas assets into cash, large numbers of Timorese people still live in poverty and without access to basic services such as sanitation, clean water and adequate healthcare and education. Although the recent Government report on poverty says that the percentage of Timorese people living in poverty has gone down, it also shows that there are still unacceptably high levels of child malnutrition and poor people; in fact the 489,000 Timorese people living in poverty in 2014 is only slightly fewer than the 509,000 reported in 2007. Most of them have not yet shared in the benefits from their petroleum wealth, which is the birth right of every Timorese citizen.

The improvement in budget execution rates says little about the quality of spending and the types of projects that are being prioritized. While people lack access to clean water around the country, the Government is building a billion-dollar highway on the South Coast in the hope that the area will one day become a petroleum industrial zone. Hundreds of millions of dollars are being allocated to building airports and a container port, while rural roads continue to deteriorate and local food production is stagnant.

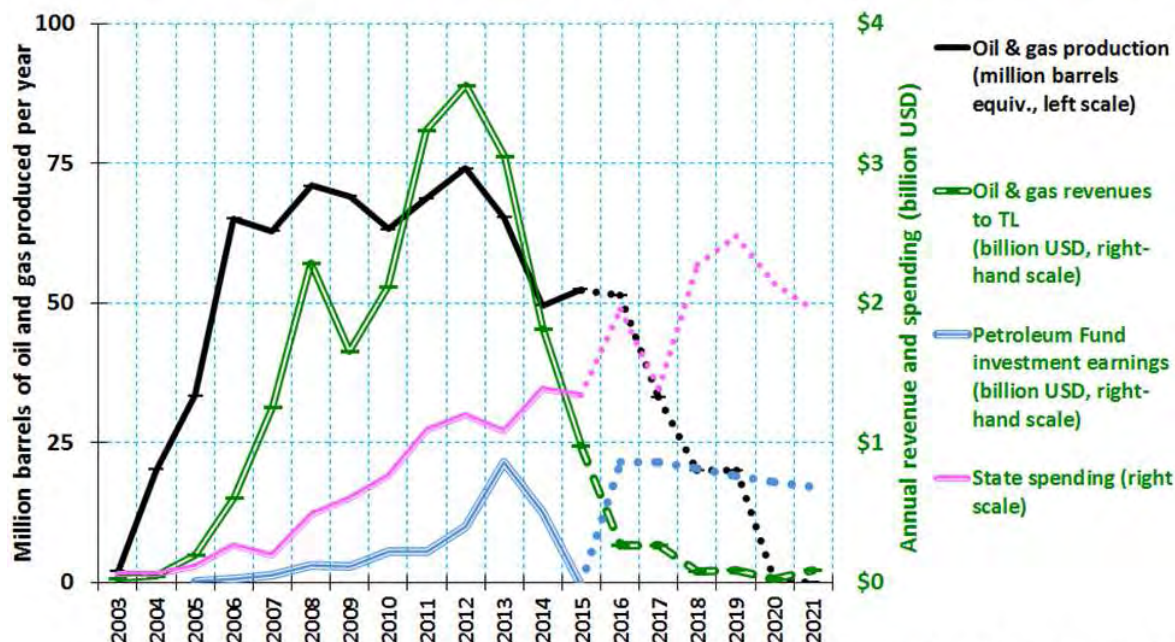
La'ó Hamutuk believes that Timor-Leste badly needs an economic and social development program which is based on facts, not fantasies. Industry experts agree that the largest proposed Government project – Tasi Mane – is economically unviable, and it is clear that it should have been re-evaluated long ago. We continue to neglect the local, non-oil economy, and agricultural production, which is vital for most people's well-being, is not growing.

For these reasons, we would like to share our analysis of Timor-Leste's current economic context and the allocations in the proposed 2017 General State Budget, so that Parliamentarians can help enact a budget which guarantees quality of life and economic prosperity for our people, fulfilling the promise of the Petroleum Fund Law to benefit current and future generations.

## **Petroleum revenues have almost ended.**

More people are realizing that Timor-Leste's oil and gas reserves have almost run out, and La'ó Hamutuk appreciates that recent reports from the Ministry of Finance and the Central Bank have shared this vital information with policy makers and the public. However, we believe that even more discussion and understanding of this reality is necessary in order to ensure that spending policies reflect the urgent social and economic situation Timor-Leste now faces.

### Timor-Leste's oil and gas income peaked in 2012 and will continue to fall.



Kitan, the smaller of Timor-Leste's two producing oil fields, ended production last year, and Timor-Leste is no longer receiving revenues from this field. It is not "suspended" – the floating infrastructure that processed its oil has sailed away. Even if world oil prices go back up, no legitimate oil company will be interested in re-starting a field which has so little oil left to recover. The investment would not be worth the return.

Furthermore, the following table<sup>1</sup> shows that Bayu-Undan, the field which has provided about \$20 billion for Timor-Leste over the last ten years, will provide only \$604 million more from 2017 to 2021 and nothing after that. In other words, Bayu-Undan has only three years of production left and will provide only minimal revenues after 2017.

**Table 2.6.3.1.1: Petroleum Revenues from Bayu-Undan and Kitan 2014-2020 (\$m)**

	2015 Actual	2016 Estimate	2017 Budget	2018	2019	2020	2021
<b>Total Petroleum Fund Revenue</b>	<b>957.5</b>	<b>1,063.5</b>	<b>1,106.3</b>	<b>906.7</b>	<b>873.3</b>	<b>710.7</b>	<b>799.3</b>
Petroleum Fund Investment Return	-21.4	747.0	842.9	824.1	788.1	681.6	708.2
Total Petroleum Revenue	978.9	316.6	263.4	82.5	85.3	29.1	91.1
BU FTP/Royalties	233.4	43.2	30.2	19.1	19.1	0.0	0.0
BU Profit oil	303.7	275.9	137.5	26.6	0.0	0.0	0.0
BU Income Tax	205.2	49.2	23.7	0.0	0.0	0.0	0.0
BU Additional Profit Tax	156.5	122.1	71.1	0.0	38.2	0.0	0.0
BU Value Added Tax	22.6	5.1	5.8	8.9	5.2	5.7	91.1
BU Other Payments	33.6	-178.9	-4.9	27.9	22.8	23.3	0.0
Kitan	23.8	0.0	0.0	0.0	0.0	0.0	0.0

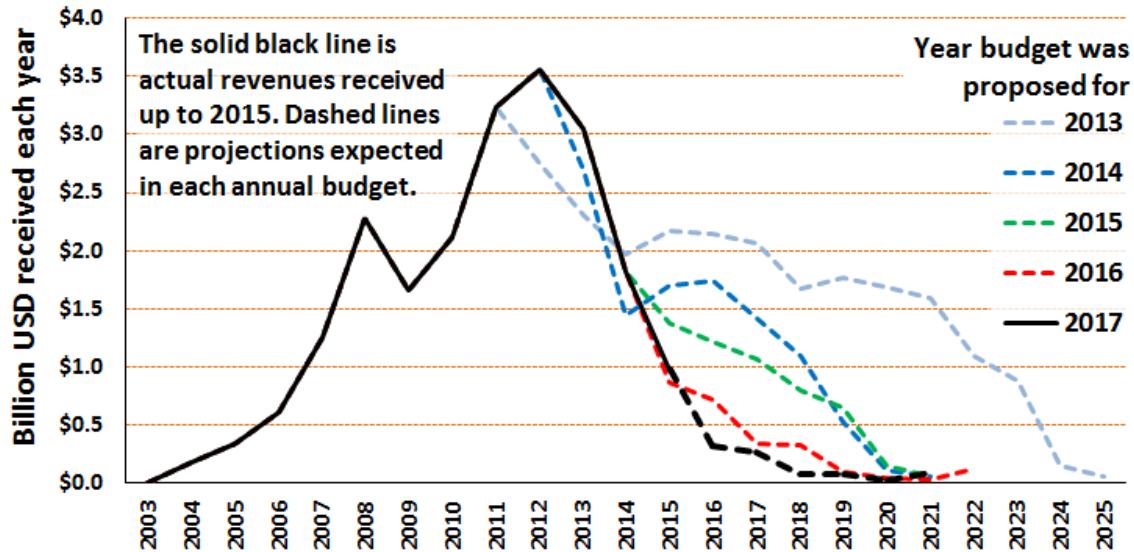
Source: Petroleum Fund Administration Unit, Ministry of Finance, 2016

The proposed 2017 budget expects that Timor-Leste will receive only half as much money from Bayu-Undan during 2017-2021 as the proposed 2016 State Budget predicted just one year ago. The latest projections continue the trend of downgrading revenue projections every year since 2013, as

<sup>1</sup> Table 2.6.3.1.1 from Book 1 of the proposed 2017 budget.

shown in the following graph. While the 2014 fall in the global oil price was significant, the reality is that the price of oil will soon be irrelevant – Timor-Leste’s producing reserves have already been almost entirely extracted. The ANPM recently authorized ConocoPhillips to drill three more production wells to suck up the last drops from Bayu-Undan; the cost of these wells will be deducted from Timor-Leste’s revenues, accelerating their decline.

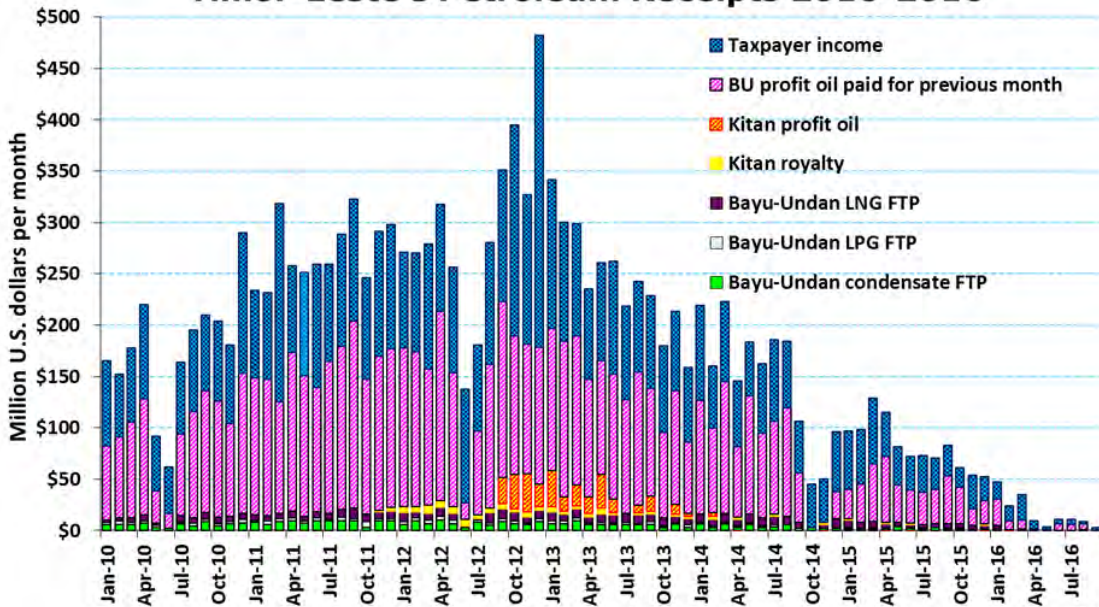
### Expected annual petroleum revenues



Graph by La'o Hamutuk based on Proposed Budget Book 1 for various years. October 2016

This graph of our monthly oil income during the last six years does not give much hope for the future.

### Timor-Leste's Petroleum Receipts 2010-2016

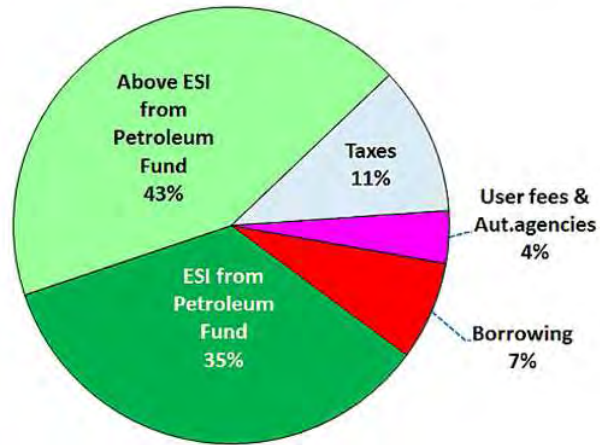


Graphic by La'o Hamutuk based on info from National Petroleum Authority, Central Bank and Ministry of Finance. November 2016

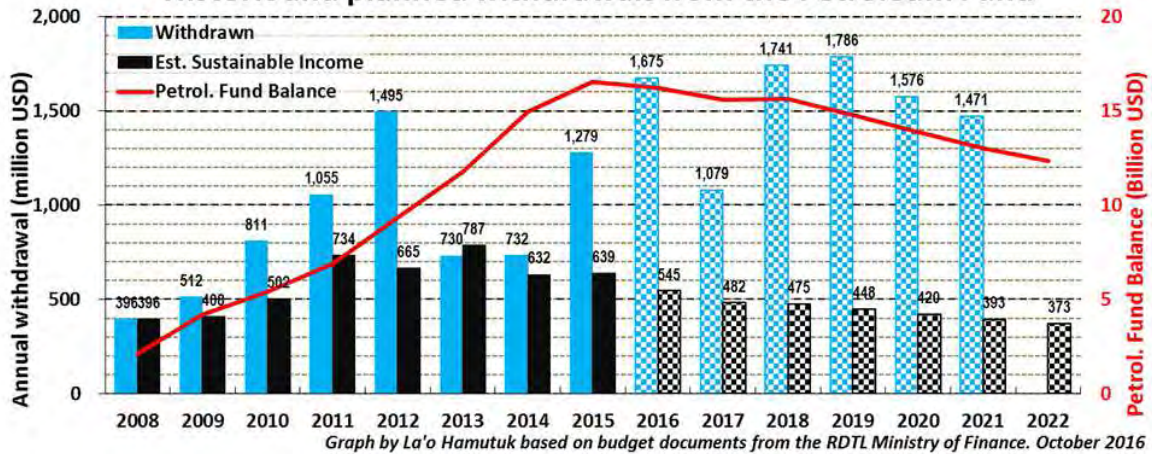
### Excess withdrawals threaten the Petroleum Fund.

As Timor-Leste's last oil reserves are extracted, and the Petroleum Fund's balance continues to fall due to withdrawals larger than income and poor investment performance, the budget envisions continuing to take large amounts from the Fund to finance its 'front-loading' policy. The proposed 2017 budget of \$1.39 billion will require a withdrawal of over a billion dollars, and the Government plans to withdraw almost four times ESI every year between 2018 and 2021. This will reduce the future ESI to less than \$400 million by 2021, and the Petroleum Fund balance will have fallen to \$13 billion, \$3 billion less than today. The 2017 budget withdraws less than is being done in 2016, not because spending is going down, but because the mid-year budget rectification already appropriated an additional \$391 million for infrastructure.

Revenue sources in proposed 2017 State Budget  
\$1,387 million total



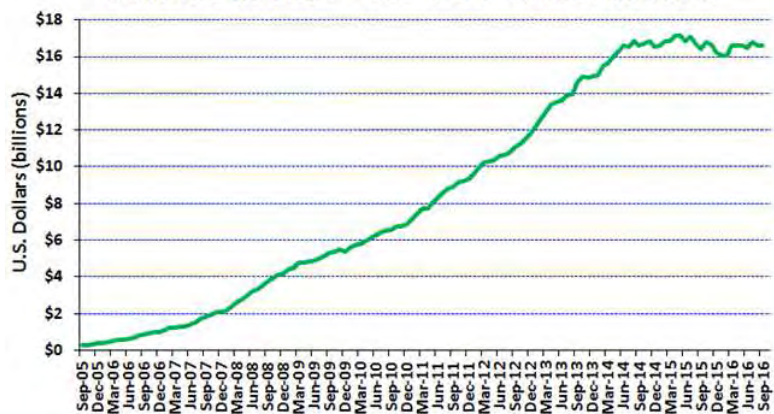
Historic and planned withdrawals from the Petroleum Fund



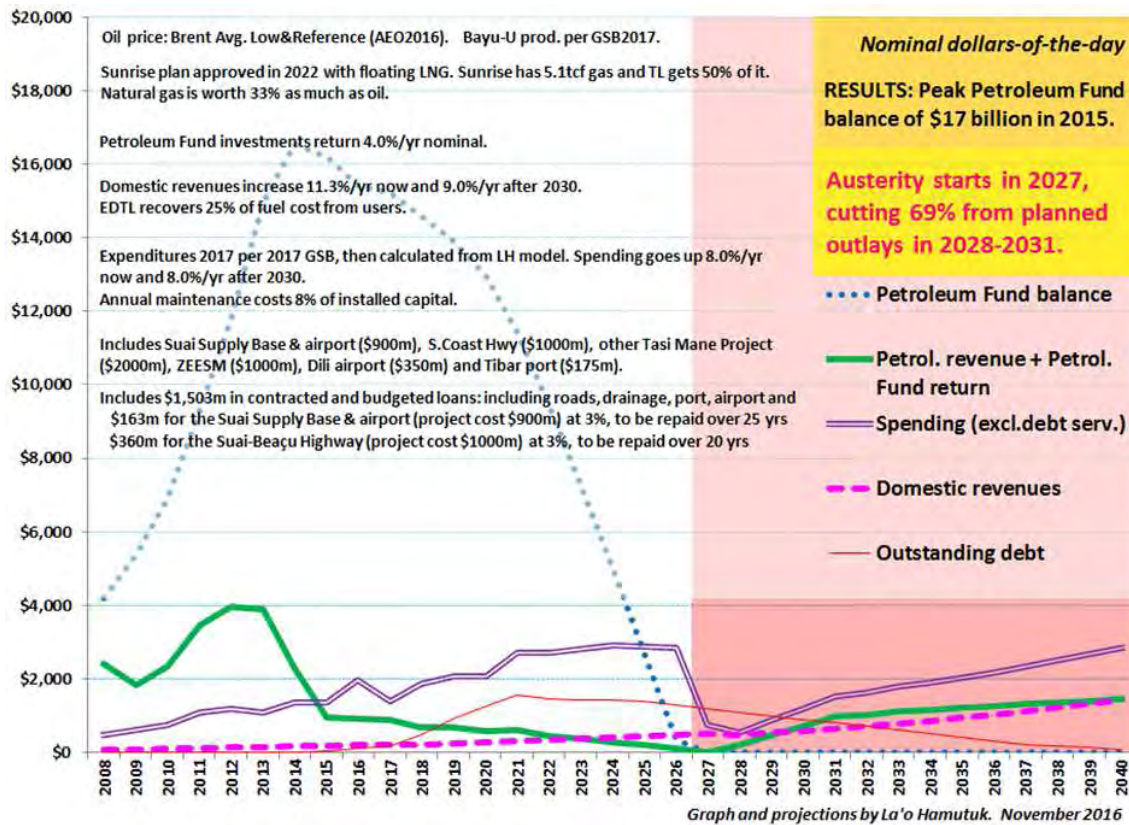
As the graph at right shows, the balance in the Fund reached its peak more than a year ago, and it will continue to fall.

While La'o Hamutuk appreciates that the Ministry of Finance acknowledges that revenues from oil and gas are ending, and that current spending plans will reduce the Petroleum Fund's balance, their prediction for when the Fund

Balance in Timor-Leste's Petroleum Fund



will run out (2032 at the earliest) is too optimistic.<sup>2</sup> If current plans are carried out, La'o Hamutuk estimates that the Petroleum Fund could be empty by 2027, as shown in the following graph. If Fiscal Reform achieves its goal to increase non-oil revenues to 15% of non-oil GDP by 2020, the Fund will last one year longer although austerity will be less severe:



One reason that the Ministry of Finance’s calculations are too optimistic is that spending projections in the Budget Books are not serious – for example, budgeted amounts on virtually every line in Book 4 (CFTL spending) increase by 4.00% each year after 2017, including for elections (which will go down after the election year) and loan repayments (which will cost more than is budgeted). This means that future spending is not accurately projected, and the Budget Books paint a misleading picture of how much will be needed. We urge Parliament to ask the Government for a more thorough analysis of future expenditures.

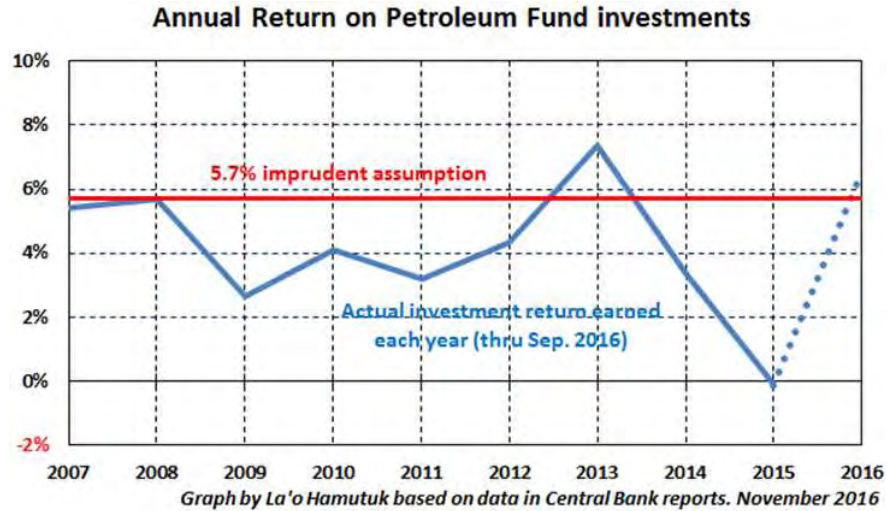
Timor-Leste has moved from dependency on revenues from selling oil and gas, to dependency on the returns from the Petroleum Fund investments. Unfortunately, these returns cannot provide as much money as we have been spending, and they will decrease as the balance in the Fund drops from repeatedly withdrawing more than the Estimated Sustainable Income (ESI).

Investment returns are not predictable, and we encourage the Ministry of Finance to use more prudent projections, with high and low cases, for investment returns. This is required by the Petroleum Fund Law: “*The assumptions made, without exception, shall be prudent, reflecting international best practice and based on internationally recognized norms*”<sup>3</sup>.

<sup>2</sup> See slides 14-16 of Ministry presentation to PFCC Conference, <http://www.laohamutuk.org/econ/OGE17/docs/MinFinKKFPOct2016.pdf>

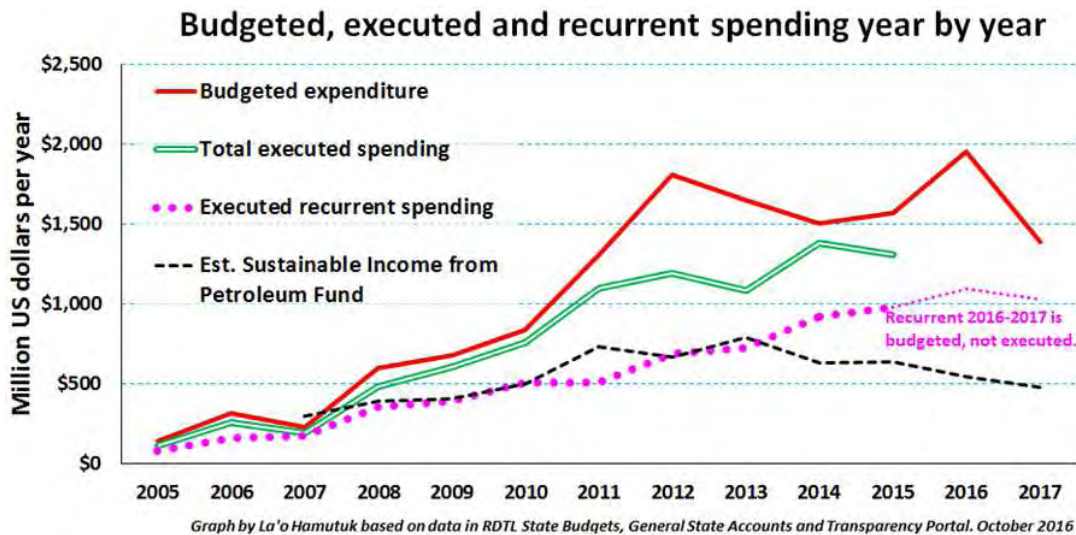
<sup>3</sup> Paragraph V in Schedule 1 annexed to Petroleum Fund Law no. 5/2005: “*Os pressupostos assumidos, sem excepção, serão prudentes, reflectindo a melhor prática internacional e tendo por base normas internacionalmente reconhecidos.*”

Although the Ministry has done this for oil price and production assumptions, they have never made prudent estimates of investment return. Rather, Book 1 of this proposed budget explains that “The expected long-term nominal portfolio return remains unchanged from



last year’s forecast of 5.7 percent nominal per annum.” However, Petroleum Fund returns were negative in 2015, 3.4% in 2014 and may be less than 5.7% by the end of 2016. In fact, since the Petroleum Fund was established, returns have exceeded 5.7% only once in the last 10 years (2013), so this can hardly be considered a “prudent” assumption.

Furthermore, even if returns increase to the optimistic levels predicted by the Ministry of Finance, they will not be enough to cover Timor-Leste’s steadily rising recurrent expenditures. The population has increased and more infrastructure has been built, which requires more money for services and maintenance. Since planned withdrawals will reduce the Fund’s value, investment returns will be less, and if other sources of revenue are not found soon, the state will not have enough money to pay public servants and Parliamentarians, maintain infrastructure, provide public services, and pay back loans to international agencies.



Finally, while returns have been a little better in 2016, the events of 2015 warn that global equities markets and currency exchange rates are unpredictable and uncontrollable, even with careful management. Timor-Leste is at the mercy of these outside forces, but we can control our own budgets and economic development. The nation must rapidly reduce wasteful spending and develop non-oil economic sectors and revenues to replace declining petroleum revenues and savings.

## Major projects should be re-evaluated.

La'o Hamutuk has repeatedly expressed concerns about the Government's policy of withdrawing in excess of ESI. Now that the Government recognizes that petroleum revenues are rapidly coming to an end, it should re-evaluate spending plans, deciding whether each capital-intensive project should be carried out. The mid-year rectification added \$391 million to infrastructure spending in 2016, and the budget books do not explain whether the unspent part of this money will be carried over into 2017. After 2017, withdrawals increase again to the high levels predicted in previous budgets.

The large withdrawals from the Petroleum Fund are mostly to pay for several major projects, such as airports in Dili, Oecusse and Suai, the south coast highway, Suai Supply Base, ZEESM, and others. The amounts being allocated to these projects are much higher than social spending and small-scale economic development: for example, the proposed budget allocates \$172 million to ZEESM, which, when added to last year's allocation of \$218 million, means that in just two years ZEESM will have received almost as much as the entire nation spent on healthcare between 2012 and 2017.

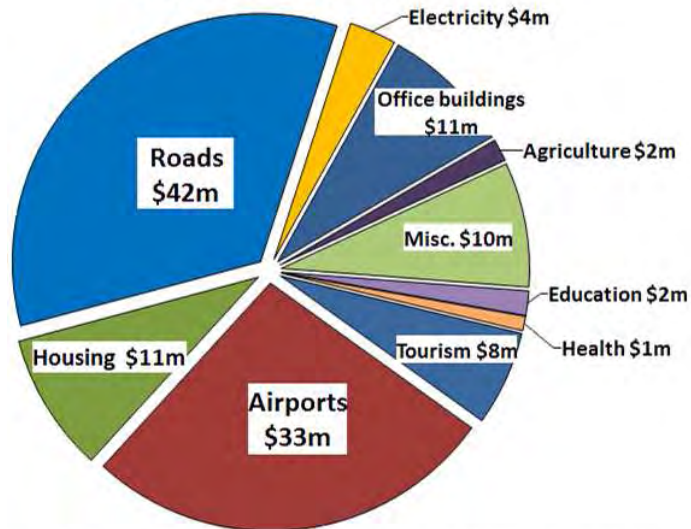
In addition to receiving a disproportionate part of the State Budget, ZEESM lacks accountability – the Public Transfer mechanism obstructs transparency and other normal finance practices. Budget Book 3C on ZEESM only discusses future plans; it says nothing about how the money already received was spent, or even if it was. We encourage Parliament to require the same accountability for ZEESM as for other public funds, in order that they and other policy makers can monitor the project more effectively.

The Government also wants to upgrade Dili airport; this budget proposes spending over \$400 million (\$128 million in Government funds and \$270 million in loans) between 2017 and 2021 on this project, which will benefit only foreigners, government officials, and the few Timorese people who can afford international air travel. Dili airport serves fewer than 250,000 passengers per year, and the project will cost more than \$300 for each passenger over the next five years.

While La'o Hamutuk agrees that the airport can be improved, the scale of expansion proposed in the budget is unlikely to generate enough returns to justify it. Increased tourism could contribute to social and economic development, but tourists don't come to visit a fancy airport, and the current one could handle many more flights than it does now. As petroleum revenues end, basic services remain underfunded and the non-oil economy stagnates, we urge decision makers to evaluate whether spending this much on Dili airport is really appropriate.

La'o Hamutuk has questioned the benefits of these projects for a long time, and many independent analysts and international agencies agree that projects like Tasi Mane and ZEESM lack clear social or economic benefits for the majority of Timorese people. In addition to their financial costs, these projects will displace local communities, use up valuable agricultural land, destroy farmers'

**TL will spend \$123 million on ZEESM infrastructure in 2017**



*Graph by La'o Hamutuk based on proposed 2017 Budget Books. November 2016*

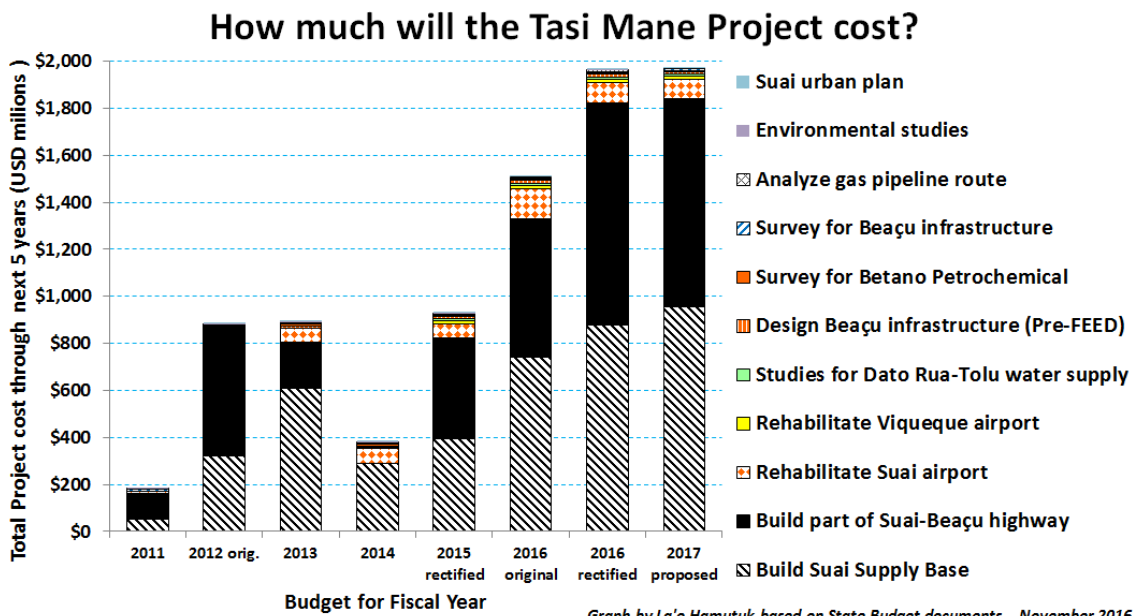


livelihoods and pollute the environment. Meanwhile, the money spent in them comes from a finite total, and is no longer available for necessary projects, sustainable economic development, equitable projects, and social services for everyone.

Objective, clear analysis of potential costs, benefits and risks should be done before projects are approved – this will prevent the people’s money from being wasted on highly risky ventures that benefit only a small subset of Timorese people. Parliament has a duty to demand that all planned projects, particularly those which will cost hundreds of millions of dollars, are justified by presenting clear evidence of their returns. We therefore urge Parliamentarians to require Government agencies to publish serious, detailed cost-benefit analyses of proposed major projects, and if their costs are likely to be greater than their benefits they should be cancelled or severely scaled-back. It is better to waste a few thousand dollars than to keep wasting millions.

### Parliament should not spend more on the Tasi Mane Project.

The Tasi Mane Project will receive \$49.3 million from the proposed 2017 State Budget, plus another \$15.4 million for Suai airport and \$11.9 million for the state subsidy for TimorGAP. Most of this money is for part of the highway and the Suai Supply Base. However, the budget proposes spending almost \$2 billion by 2021 on Tasi Mane, and we believe that it will cost many more billions to finish the highway and to build other components including the refinery/petrochemical plant in Betano and the LNG Plant in Beaçu.



Since it started, La'o Hamutuk has seen this project as wasting the people’s money for the benefit of foreign contractors and Timor-Leste’s petroleum agencies. We have often asked TimorGAP, E.P., as the owner of this project, to produce evidence that it is commercially viable to the public, even though they continue to ask Parliament to approve money for both it and for their operational costs, but they refuse to do so.

In 2015, the *Tribunal Rekursu* rejected the \$719 million Suai Supply Base contract with Hyundai. In our submission on the 2016 Budget Rectification, La'o Hamutuk asked Parliament not to allocate more money to the Suai Supply base because “there is no way that a legitimate new tender can be held in time for construction to start this year.”<sup>4</sup> Unfortunately, distinguished Members did not

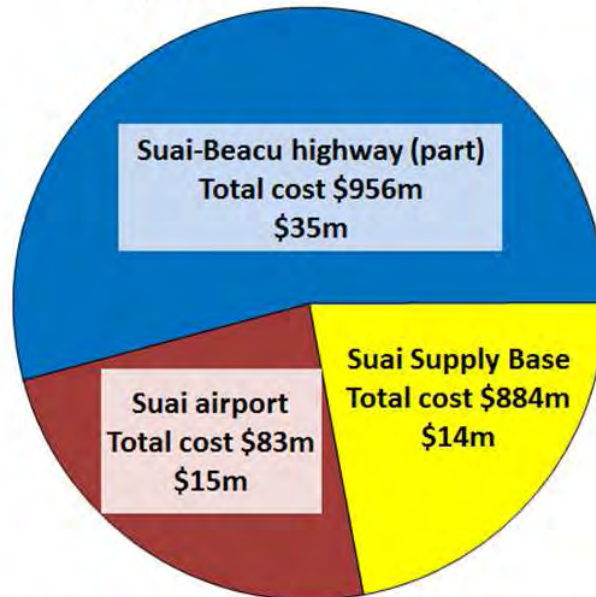
<sup>4</sup> <http://www.laohamutuk.org/econ/OGE16/Ret/LHSubmissionPNOR12Jul2016En.pdf>

consider our ideas, although you also knew that the Court had rejected the contract, Hyundai had pulled out of this project, and you had no evidence of its economic viability.

The \$65.3 million that the Rectified 2016 Budget allocates for the Suai Supply Base will not be spent in 2016 as there is no company to implement the project, not even a tender. However, the proposed 2017 Budget estimates that it will all be spent this year, and asks for \$14 million more in 2017 and \$572 million more in 2018-2021. This project should no longer be a drain on state spending, and it makes no sense to add nearly a billion dollars more to the tens of millions which have already been poured into this ill-conceived boondoggle.

Other Tasi Mane Project components which are already underway include the 156km highway between Suai and Beacu. The Indonesian company PT Vikrama Karya, which did design studies for this project, said it would cost \$1.3 billion, based on similar projects in Indonesia. However, as projects here are much more expensive than in Indonesia, it could cost much more than that.

### TL will spend \$65 million on Tasi Mane Project infrastructure in 2017



Graph by La'o Hamutuk based on proposed 2017 Budget Books. Nov. 2016

In 2015, China Overseas Engineering Group Co. (COVEC) and its consortium won a contract to build the first 30 km between Suai and Fatukai, but we don't have information about how much the company will be paid. In the 2016 rectified budget, the government allocated \$117 million for this project in 2016 alone. The proposed 2017 budget will allocate \$35 million in 2017 and another \$371 million through 2021, from the Infrastructure Fund. The proposed Budget expects to spend another \$360 million in borrowed money on the highway, although no lender has been identified, bringing the total spending on the highway between 2016 and 2021 to \$883 million. To make things worse, this pays for only part of the highway, which will be built in five 30-km phases, so spending will continue after 2021.

As you know, Kitan is already shut down, Bayu-Undan will be empty soon, and the situation with Greater Sunrise remains uncertain. In addition, the ANPM hasn't held a new bidding round to attract oil companies to Timor-Leste's offshore and JPDA territory since 2006, perhaps because companies are more cautious about where to invest their money. Therefore, we think Parliament should cancel the appropriations for the Tasi Mane Project and ask TimorGAP to provide a well-founded, realistic, reasonable analysis of the economic and social costs and benefits of the project.

TimorGAP's report to Parliament last week states that the company wants to "liberate" more land in the areas to be used for the LNG Plant in Beacu and the refinery/ petrochemical facility in Betano during 2017.<sup>5</sup> Evicting community residents from their homes and farms will create even more social problems, as well as imposing a burden on public finances. We urge Parliamentarians to prevent TimorGAP from displacing people before we are certain that the Greater Sunrise gas will come onshore at Beacu, or Timor-Leste discovers many more oil and gas fields in the Timor Sea.

<sup>5</sup> <http://www.laohamutuk.org/econ/OGE17/docs/TimorGAP28Oct2016.pdf>, pages 6-7

National Parliament can learn from the case of “liberating” community land in Aldeia Lohorai, Suku Matai, Maukatar, Covalima for construction of Suai airport, which shows the weakness of TimorGAP in this sector. When La’o Hamutuk researched in Suai in September 2016, we discovered that even though impacted people had received financial compensation and new houses, they had no land to cultivate for their daily lives and their children’s futures.

Once again, we urge Parliament to demand that TimorGAP provide in-depth information about land takeovers, and stop sacrificing people’s lives for fantastic dreams that will probably never be realized. As you know, Parliament will soon enact laws regarding land, including a mechanism to protect human rights when land has to be expropriated for the public interest. TimorGAP and other proponents of future projects should wait until they are passed, and follow legal processes before “liberating” and more land from local communities.

### **Do the petroleum agencies provide value for money?**

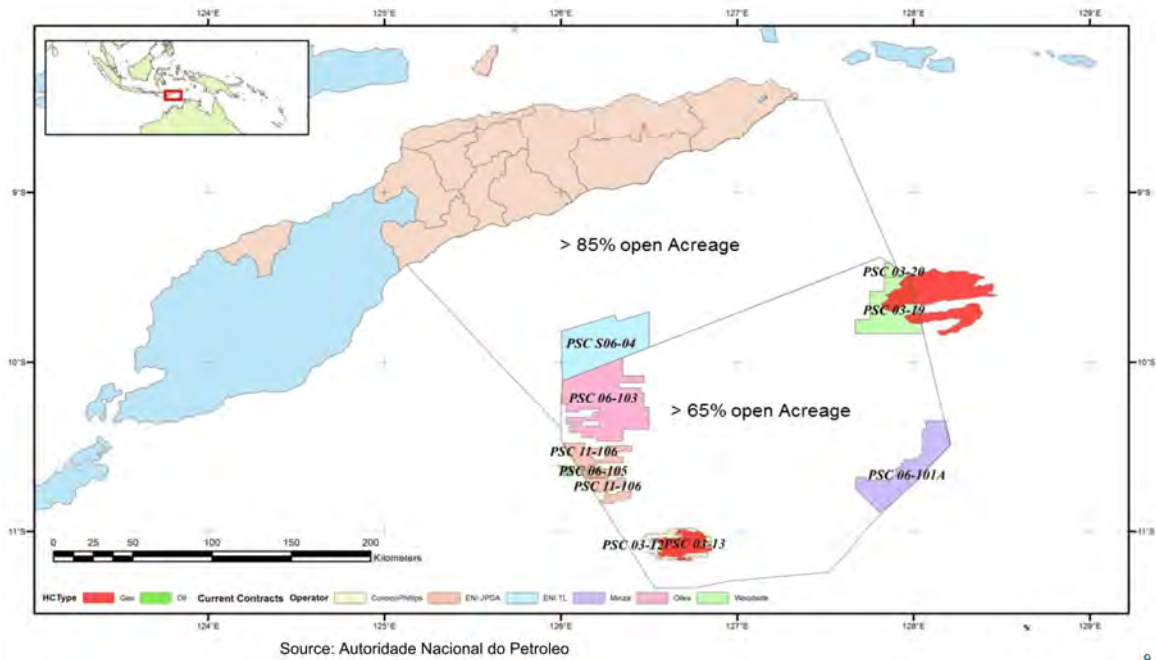
The proposed 2017 budget will double the state subsidy for TimorGAP, from \$6 million this year to \$11.9 million. In addition to promoting and managing the ill-advised Tasi Mane megaprojects, TimorGAP’s main activities seem to be propaganda to mislead people that there is a lot of undiscovered oil and gas in Timor-Leste, paying millions to Chinese companies for seismic exploration in unpromising waters, building petrol stations which compete with private companies that do not need state subsidies, serving on joint committees with Australia about managing the stalled Sunrise project, starting short-lived joint ventures (such as Gap-MHS) to transfer part of the operational costs of Kitan from the nation’s petroleum revenues to their own treasury, and dreaming of trips to Cuba for speculative oil exploration.

Although their report to Parliament does not include a balance sheet, TimorGAP’s 2015 Annual Report shows that the state-owned company ended that year with \$1.2 million in the bank. The \$12 million they are asking you for now is twice as much as the office of the President of the Republic has asked for, or more than 2/3 of Parliament’s entire proposed 2017 budget. Is it worth it?

The National Petroleum and Minerals Authority (ANPM) ended 2015 with an \$8 million cash reserve, which has probably increased by at least a million during this year. Yet ANPM is asking for a \$1.8 million transfer from the 2017 state budget. Why is a regulatory agency operating at a profit? Why is the surplus they take in not deposited into the Petroleum Fund, as the law requires? Why do they continue to ask for a subsidy from public funds?

Both TimorGAP and ANPM work hard to persuade the public and policy-makers that Timor-Leste has vast unexplored maritime territory, with lucrative deposits of oil and gas just waiting to be tapped. At the Petroleum Fund Consultative Council last week, they talked about “6.3 billion barrels” (six times as much as Bayu-Undan) which will sell for \$372 billion, creating tens of billions of dollars in state revenues.<sup>6</sup> They showed maps like this one to encourage people to share their intoxication with oil, and mislead them into thinking that there are large areas ‘open for exploration’:

**UPSTREAM ACTIVITIES & POTENTIAL:  
EXISTING CONTRACTS**

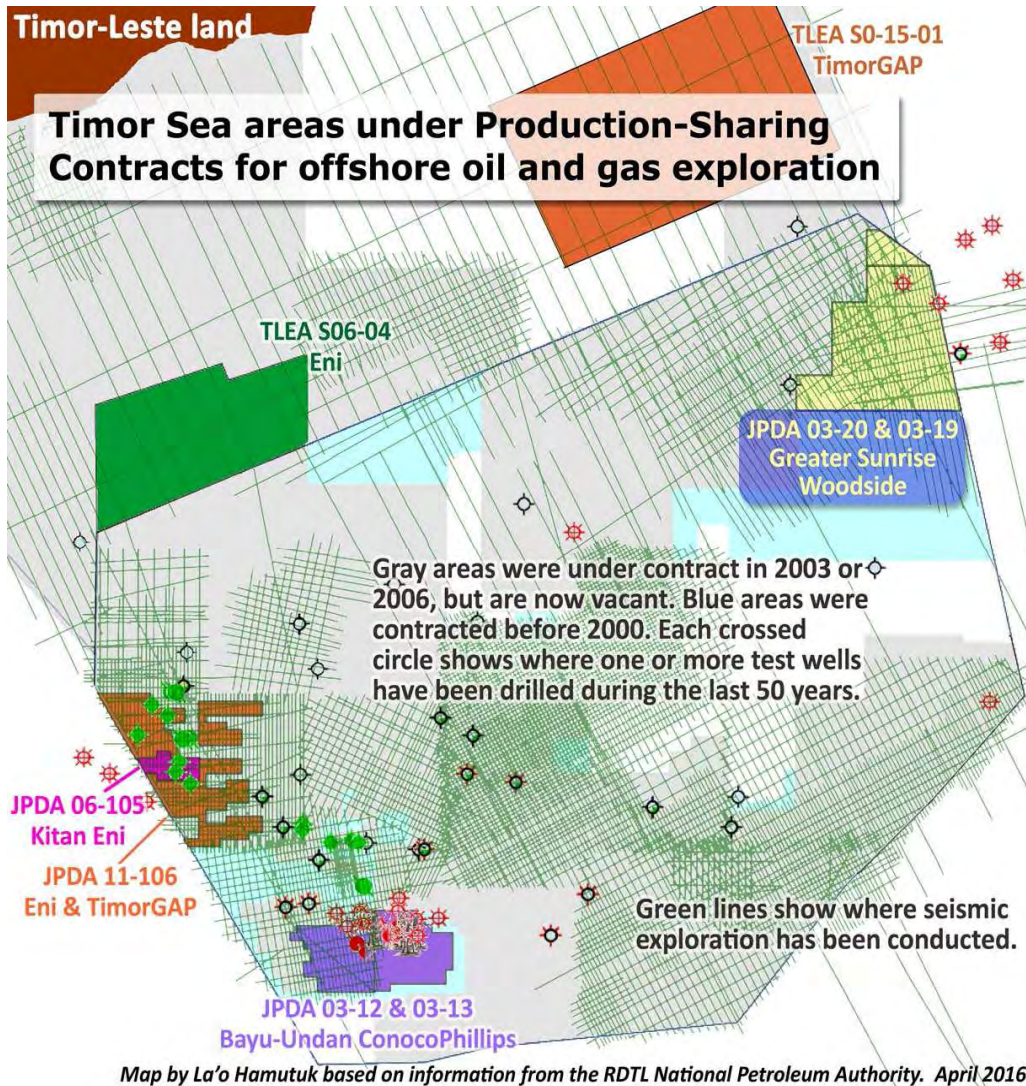


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However, oil companies have been looking for oil and gas in our limited maritime territory for sixty years (Greater Sunrise was discovered in 1974), and, despite extensive exploration and hundreds of test wells, the only commercial discovery since 1995 has been Kitan (which provided 3% as much revenue as Bayu-Undan). The “open acreage” indicated on the above map is because companies tried and failed to find commercially valuable reserves in those areas, and have relinquished their contracts (including PSC 06-103 and 06-101A which are still on the map).

<sup>6</sup> <http://www.laohamutuk.org/econ/OGE17/docs/TimorGAPKKFPOct2016.pdf>

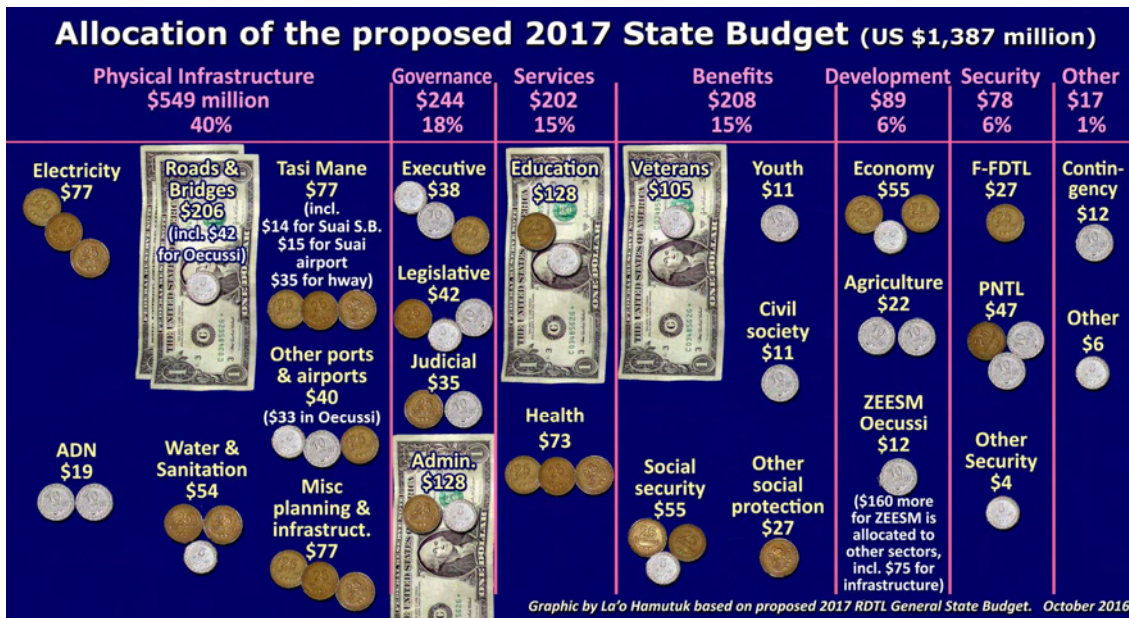
A more accurate map, showing the contractual history, looks like this:



Oil companies know that history well, and they have detailed geological information from their past research. Perhaps that is why no company already involved in the area made a bid in the only bidding rounds Timor-Leste has ever conducted, ten years ago. Even more telling, it's why ANPM has not held a bidding round since then – it would be embarrassing if no legitimate companies were interested. The only new contracts since 2006 have been signed with TimorGAP, who spends public funds and is never held accountable for them.

## Invest in social services to improve people's quality of life.

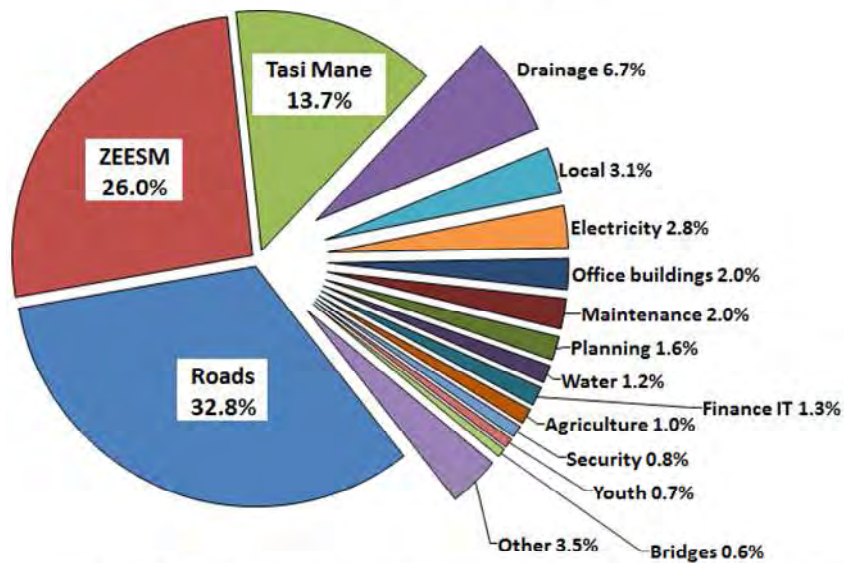
While the Government allocates large sums for projects with dubious benefits and fantasizes about unlimited petroleum wealth, large numbers of Timorese people have inadequate jobs, nutrition, water, education, healthcare and sanitation. Investment in public services and economic programs will improve the quality of people's lives and create badly-needed jobs, increasing families' income and improving their daily existence and the future for their children. This will then stimulate Timor-Leste's domestic economy by increasing private sector profits, wages and investment in local industries. It will also provide the State with revenues from taxes, reducing our dependency on the Petroleum Fund and moving us towards sustainability and self-sufficiency.



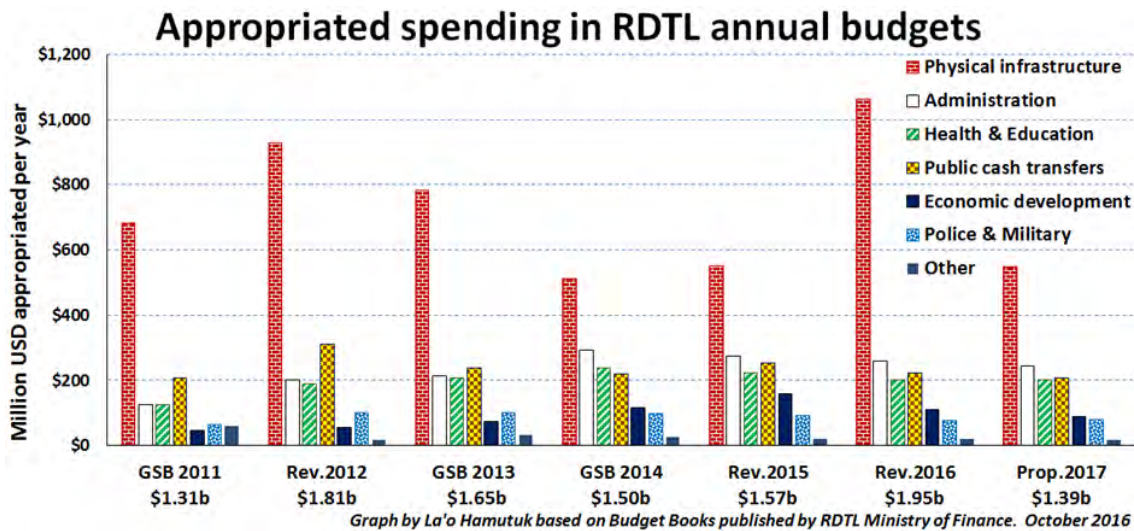
These programs – unlike the major projects currently being proposed by the Government – do not require billions of dollars in capital expenditures, investment from multinational companies and foreign loans; they do require serious analysis of the needs of the majority of Timorese people, which can then be used to design and channel funding to specific projects with the highest social impact and the best economic returns for local people and the state.

Unfortunately, while the Government has allocated \$250 million for Tasi Mane and ZEESM in 2017 alone, health care receives only \$73 million, and proposed funding for social security and youth is less than \$100 million (excluding veterans' payments). While the allocation for health has increased slightly since 2016, it is still not enough given the urgent health needs of large numbers of the population and the high levels of inadequate access and malnutrition. La'o Hamutuk recommends that the allocations for health and essential social support programs be increased to meet the needs of the most vulnerable sections of society, and that monitoring of spending is improved to ensure that funds are not wasted or misappropriated.

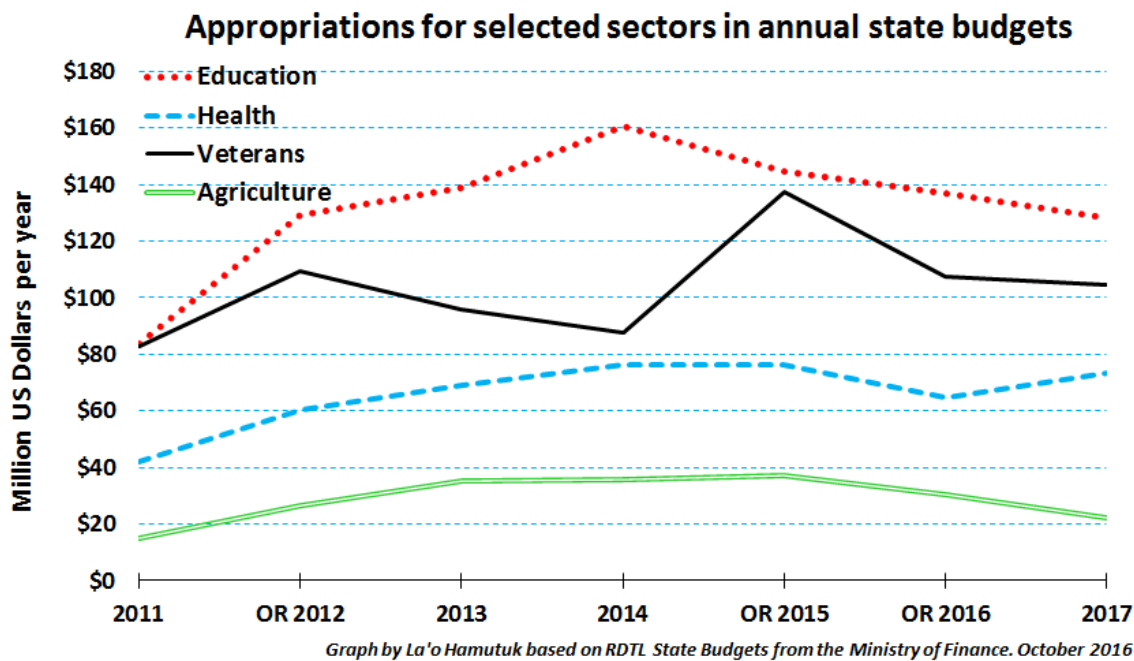
### TL will spend \$472 million to build and maintain physical infrastructure in 2017



Graph by La'o Hamutuk based on proposed 2017 Budget Books. November 2016



Allocations for education have fallen every year since 2014, and this budget proposal continues that trend, allocating only \$128 million in 2017, compared to \$137 million last year. Education from primary school should be a priority, as early learning will lay the foundations for today's children to become healthy, productive citizens who can advance our nation's social and economic development.



Finally, water and sanitation systems receive only \$54 million in 2017 – while this is an improvement compared to the \$18 million average over the previous three years, it is still inadequate to address the basic needs of large numbers of people, particularly in rural areas, many of whom lack toilets and have to walk long distances every day to collect water for cleaning and cooking.

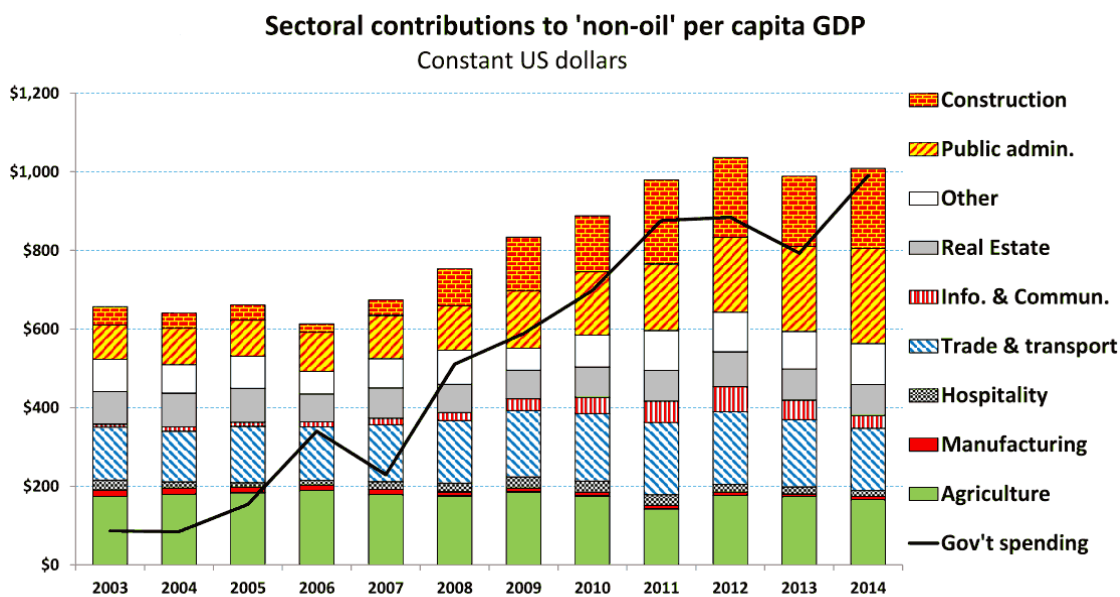
If the Government scales megaprojects down to more realistic levels, there will be more than enough resources available to provide for basic services and rural infrastructure which will dramatically improve most people's lives.

## Invest in equitable, sustainable economic development.

While the petroleum industry and large projects are prioritized, agriculture and other sustainable economic sectors continue to be neglected. Despite agriculture's vital importance to income, nutrition, employment, food security and sustainable development, the 2017 budget proposes allocating only \$22 million to agriculture, down from \$30 million in 2016. National statistics reflect the lack of prioritization given to agriculture in the State Budget – the Government's *National Accounts 2000-2014*, published in June this year, estimates that agricultural contribution to GDP fell by 2.6% in 2014, while productivity on average has not improved since independence.

There are many ways in which current policies could be improved to help local farmers produce more. For example, the proposed 2017 budget allocates \$2 million to MCIA for "rice imports and the support of local products", which "will support the local rice market" and be used for school feeding and disaster relief. We understand that there is not enough local rice to meet the need, which is why some will be imported. However, cheap food imports are discouraging local producers from investing in increased production, which is essential for the future. Therefore, we recommend that instead of subsidizing rice from abroad, farmers could be assisted through irrigation and other programs to grow rice and other food products for children in local schools.

Furthermore, the *National Accounts* report shows that the only sectors of the economy which are growing are those which are driven by state spending: construction and public administration. Other areas – telecommunications, retail, hospitality, real estate and transport – have barely grown or have fallen, while productive sectors like manufacturing and agriculture have been stagnant since 2002.



Although 'free market' economic theories see the private sector as the main driver of economic growth, state-led investment has contributed to successful development in many countries, including South Korea, Taiwan and Singapore. La'o Hamutuk believes that the State can play a strong role in stimulating the economy through smart public investment in strategic industries. However, this should be done through economic programs which are designed to maximize employment and local productivity, especially in areas such as agriculture, food processing and human-scale infrastructure, rather than from intoxication with petroleum. These programs could be implemented in a decentralized way, involving local communities in deciding what projects are needed, rather than being designed by people who prioritize national GDP numbers and the needs of foreign investors.

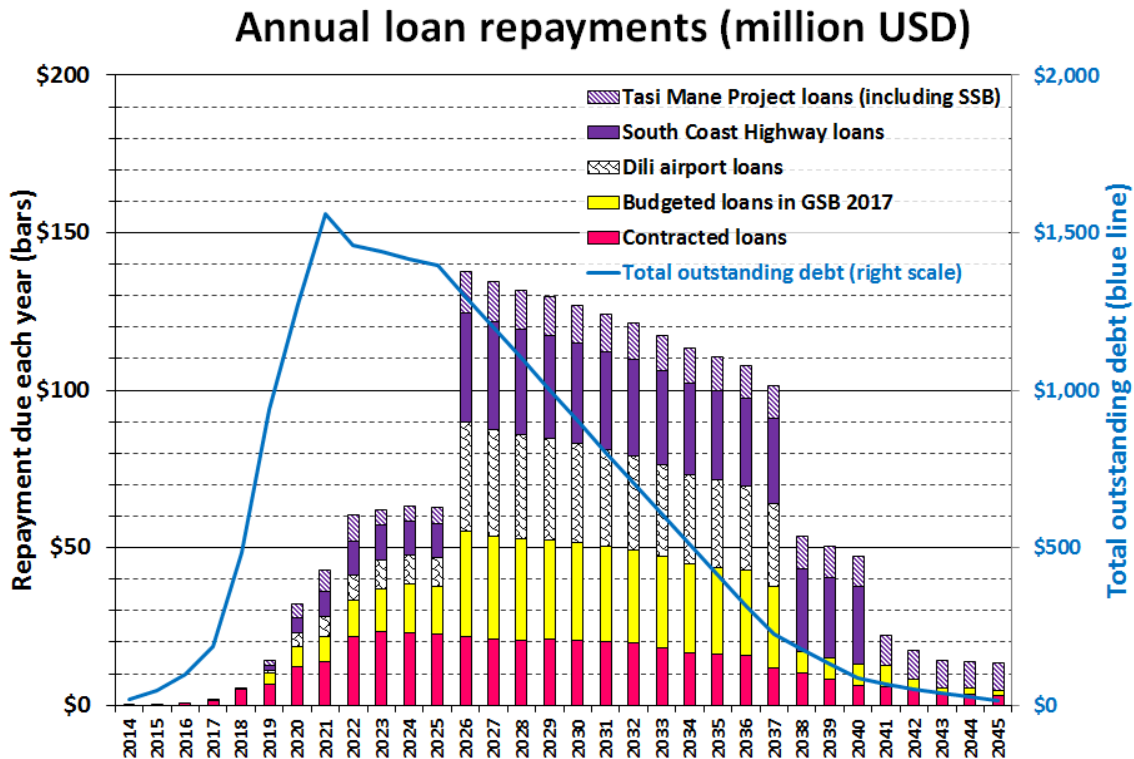


## Loans are increasing, and the budget should include repayment obligations.

Under the current budget proposal, the Government plans to borrow more than \$1.4 billion over the next five years, almost \$500 million more than was predicted in the original 2016 budget a year ago. This includes more than \$320 million in loan contracts which have already been signed for road projects and the drainage system in Dili, and additional loans to pay for Tibar port (\$220 million), the south coast highway (\$360 million) and Suai supply base (\$274 million). However, Government has not yet identified lenders for most of these projects, as international agencies involved in Timor-Leste are reluctant to finance the Tasi Mane project, and the Government has already allocated funds for its share of the construction of Tibar port.

Although 'concessional' loans from international agencies come with relatively low rates of interest, La'o Hamutuk is concerned that the Government may seek loans from commercial banks or other institutions that may see Timor-Leste's petroleum wealth as a guarantee that their loans will be repaid, regardless of whether the project being funded is viable. La'o Hamutuk encourages Parliament to ask the Government about plans to borrow for these projects. As loan-financed projects impose obligations on future governments and generations, it is essential to justify them with clear cost-benefit and debt sustainability analyses.

Repayments of already-signed loans will begin in 2017, and the proposed budget allocates \$1.5 million. However, the amounts allocated for 2018 onwards are far too low. La'o Hamutuk estimates Timor-Leste will have to repay at least \$5 million in 2018, \$10m in 2019, \$22m in 2020 and \$28m in 2021, even without loans for Tasi Mane or Tibar Port. Budget Book 4 says repayments in 2021 will be \$1.8 million in 2021, less than one-tenth of the actual amount. Before we allow politicians to impose even more debt obligations on our people, we need to be honest about what we are committing to. In a decade, we could be paying \$135 million or more every year to international lenders.



Graph by La'o Hamutuk based on 2017 state budget, information from lenders, and LH sustainability model. October 2016

The IMF's 2016 Article IV report on Timor-Leste<sup>7</sup> downgraded Timor-Leste's debt sustainability profile, saying that increased borrowing is putting Timor-Leste at risk of falling into unsustainable debt. We hope that Parliamentarians understand the risk of escalating borrowing from international lenders while our future financial situation is uncertain, and we urge you to reconsider forcing future generations of Timorese people – who will live at a time long after petroleum revenues have ended – to pay for today's expenditures.

## **Conclusion: Which path is best for Timor-Leste?**

Although more members of Government talk about the non-oil economy and improving people's quality of life, the proposed 2017 budget still prioritizes large projects which have dominated planning and spending over the last several years. People's basic needs are not being met, but the Government dreams about developing the petroleum industry, expanding airports, building highways and trying to make Timor-Leste into an international shipping hub.

These projects may benefit a few wealthy individuals and foreign companies, but they are part of an unsustainable, unjust and unjustifiable development path which neglects the interests of most Timorese people. La'o Hamutuk therefore urges Parliament to carry out your Constitutional duty, and demand that the Government prioritize the well-being of our people, and produce realistic cost-benefit analyses of all major projects, while greatly increasing allocations for social services and sustainable economic development.

This is essential to realize Timor-Leste's people's right to a stable, peaceful future, free from poverty, deprivation and conflict. Unfortunately, the current path that the Government is leading us down leads to economic crisis and potential instability, and we therefore urgently need to change course. As the proverb says, "if we don't change direction we are likely to end up where we are going" – and Timor-Leste must not become like Nauru, a victim of the curse of squandered non-renewable resource wealth.

You have to decide who to believe – the petroleum officials who say that Timor-Leste still has vast amounts of undiscovered wealth, or those like La'o Hamutuk who say we need to design policies based on what we know for sure. It may help to consider what happens if you make the wrong choice.

If La'o Hamutuk is right and Parliament ignores our advice, most of Timor-Leste's non-renewable wealth will be squandered on unprofitable projects. When the money runs out about ten years from now, our economy will not yet be self-sufficient, sustainable or inclusive, but will continue to rely on state spending and imports. When the Petroleum Fund is exhausted, the economy will collapse, people will starve and those who can will defend their privileges against an angry majority. International lenders will still demand repayment, and may intervene to "structurally adjust" our economy and society. International agencies may provide emergency assistance for our most vulnerable people, or they could say that Timor-Leste's citizens have to live with the consequences of their leaders' decisions.

On the other hand, if Timor-Leste does actually have a lot more oil and gas but Parliament takes our advice and cancels unworthy projects while encouraging investment in our people and developing sectors other than oil, most people's quality of life will gradually improve, our human resources will get stronger, and our economy will become more productive and less import-dependent. Legitimate international oil companies will analyze Timor-Leste's potential and, when they find that there are resources which can be profitably developed, they will invest their own money to explore for and extract oil and gas, leading to commercial development. Timor-Leste may get a slightly smaller share of this wealth because the processing is done by private companies, but we will still get significant revenue from royalties and taxes. However, we will have avoided the

<sup>7</sup> <http://www.imf.org/external/pubs/cat/longres.aspx?sk=44006.0>

dire scenario in the previous paragraph, and will be able to use all of this money to advance development for our economy and our people, rather than repaying loans.

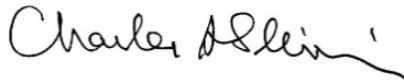
La'ó Hamutuk hopes that our recommendations will help your Excellencies assess and revise the proposed 2017 budget and the plans it represents. We are happy to provide further information or testimony if needed, and look forward to continuing to participate in this important process.

Thank you very much for your attention.

Ami be saran lia,



Juvinal Dias



Charles Scheiner



Adilson da Costa Junior



Marta da Silva



Celestino Gusmão



Niall Almond

La'ó Hamutuk Researchers on Economy and Natural Resources